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No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1988

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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TABLE OF AUTHORITIES

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In their brief, respondents have given little more than lipservice to the principal ground relied upon by the court of appeals in invalidating the Secretary's curative retroactive cost limit rule – that the APA bars the promulgation of retroactive rules. They instead base their claim of invalidity primarily on two alternative grounds: (1) a sweeping assertion (Br. 22) that curative rulemaking is "an affront to the integrity of the administrative process"; and (2) a narrower argument that the Medicare Act itself bars the promulgation of a retroactive cost limit rule even where, as in this case, it is merely curative in character.

As we explained in our opening brief, however, there is nothing inherently suspect or improper about curative lawmaking. A curative rule avoids the element of unfair surprise associated with other forms of retroactive lawmaking. And if curative rulemaking were not possible, mere procedural errors by administrative agencies could be parlayed into interim victories on the merits, conferring an unjustified economic windfall on those seeking federal reimbursement. Far from being the

"affront" claimed by respondents, therefore, curative rulemaking protects legitimate claims of entitlement and keeps the administrative process focussed on the substantive aspects of a regulatory program.

There is likewise no merit to respondents' narrower claim that the Medicare Act bars the Secretary's retroactive cost limit rule challenged in this case. As explained in our opening brief, that rule may be sustained as a valid exercise of the Secretary's general rulemaking authority under the Act, and it was also independently authorized by Section 1861(v)(1)(A)(ii) (Clause (ii)) of the Act. Contrary to repsondents' claim, the statutory language of Section 223(b) provides no support for their contention that cost limit rules must always be prospective. And the legislative history upon which respondents rely—one sentence reproduced in two legislative reports—does not purport to address the propriety of a retroactive rule, such as the one at issue here, that is merely curative in character.

Respondents' attempted refutation of the Secretary's construction of Clause (ii) also fails. Clause (ii) need not "override" Section 223(b) in order to authorize the Secretary to promulgate a retroactive cost limit rule. Indeed, as explained in our opening brief, Clause (ii) empowers the Secretary to promulgate a retroactive cost limit rule precisely because Section 223(b) authorizes the Secretary to utilize cost limit rules as a method for determining a provider's level of reimbursement. A scheme for "retroactive corrective adjustments" through rules of general application is a sensible, indeed necessary, complement of Congress's decision to authorize cost limit rules.

1. Respondents repeat (Br. 19-22) the basic rationale of the court of appeals' ruling that the APA bars the promulgation of retroactive rules, but they do not seriously defend it. Indeed, respondents, by agreeing that retroactive rules are permissible in certain circumstances,[1] but suggesting no way in which that

[1] Respondents admit (Br. 19) that the APA does not restrict rules of "secondary retroactive effect" (rules that apply to ongoing activities that commenced prior to the rule's effective date) and, more importantly, they also admit (Br. 20 n.22) that the APA permits rules of "primary retroactive effect" in certain circumstances. According to respondents (*ibid.*), the latter type of retroactive rule is permissible under the APA in "[e]xtraordinary circumstances" or where "unavoidable" or "necessary," but only so long as "special care" is taken to ensure that "interested parties are not unduly harmed."

result can be squared with the court of appeals' analysis of the statutory language, have effectively conceded that the court of appeals' ruling is incorrect. If, as the court of appeals held (Pet. App. 13a), the APA's requirement that rules have "future effect" (see 5 U.S.C. 551(4)) pertains to *what* transactions a rule applies (*i.e.*, past or future), rather than merely to *when* a rule applies (*i.e.*, is legally effective), then there is no room under the APA for even those limited exceptions admitted by respondents.

As explained in our opening brief (at 21-25), we believe that the APA's "future effect" requirement refers simply to when a rule applies, *i.e.*, to when it is legally effective. The APA imposes no limitation on an agency's decision to apply a rule retroactively, *i.e.*, to a transaction that occurred in the past, except, of course, that such a decision is subject to judicial review under the APA's "arbitrary and capricious" standard (5 U.S.C. 706(2)(A)). Not surprisingly, respondents point to nothing in the APA's statutory language or legislative history to support the more exacting standard of judicial review that they propose to apply to such rules (see note 1, *supra*), which is merely a legal standard of their own invention.

Nor do respondents or any of their supporting amici undermine our showing that the APA's legislative history is consistent with the longstanding view—shared by courts and commentators alike—that agencies may promulgate retroactive rules (see Pet. Br. 21-23, 25-34). The statements in the reports and debates and in the *Attorney General's Manual on the Administrative Procedure Act* (1947) [hereinafter *Attorney General's Manual*] relied upon by respondents (Br. 20-21 & nn. 24, 25) and their amici (see Amer. Hosp. Ass'n (AHA) Amicus Br. 7-8) are, at best, inconclusive. For instance, Representative Gwynne's statement that " 'rules or regulations which have the effect of law must * * * go into effect at some future date,' "

quoted by respondents (Br. 20 n.24 (quoting Senate Comm. on the Judiciary, 79th Cong., 2d Sess., *Administrative Procedure Act—Legislative History* 374 (1946) [hereinafter *APA Leg. Hist.*]), actually supports our view that "future effect" refers merely to the legal effectiveness of the rule (*i.e.*, when a rule applies). The other cited references to "future effect," "future law," and "future conduct" likewise do not purport to answer the retroactivity question posed here. They are instead consistent with our view that a rule may be legally effective in the future, yet once effective, may govern transactions in the past. None of those comments suggests that a rule can apply only to "future conduct."

In fact, in passages acknowledged by respondents (Br. 21-22), Congress directly addressed the retroactivity issue only once in the legislative history. That reference, together with a directly relevant comment in the *Attorney General's Manual,* fully supports our view (see Pet. Br. 30-33). The former draws the very distinction we do between a rule's legal effectiveness and its applicability to past conduct. See H.R. Rep. 1980, 79th Cong., 2d Sess. 49 n.1 (1946), *reprinted in APA Leg. Hist.* 283 n.1) ("The phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future."). And the latter affirmatively denies that retroactive rules are barred. See *Attorney General's Manual* 37 ("Nothing in the Act precludes the issuance of retroactive rules when otherwise legal * * *."). Unlike respondents (Br. 22), we do not believe that the *Attorney General's Manual* erred by "using the term 'retroactive rules' loosely." Its message is unambiguous.[2]

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[2] There is likewise no merit to amicus AHA's effort (AHA Br. 10) to discount Congress's omission from the APA of proposed language that would have explicitly prohibited retroactive rules. It is well settled that such legislative history can be a weighty indicator of congressional intent. See *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384, 391-392 (1951) ("In view of this history we can only conclude that, if the draftsman intended that the nonsigning retailer was to be coerced, it was strange indeed that he omitted the one clear provision that would have accomplished that result."); *Wright* v. *Vinton Branch*, 300 U.S. 440, 458 n.2, 459 n.4 (1937); *Federal Trade Comm'n* v. *Raladam Co.*, 283 U.S. 643, 648 (1931). Contrary to amicus AHA's suggestion (Br. 10 n.6), moreover, we do not contend that Congress's failure to adopt an introduced bill is, by itself, weighty evidence that Congress rejected the substance of the bill (or even considered it). Rather, the legislative history upon which we rely is weighty because, as described in our opening brief (at 25-29), it shows that *in enacting* the APA Congress actually considered and rejected proposed language that would have explicitly accomplished the very ban on retroactive rules that amicus AHA nonetheless claims that Congress intended to impose.

2. Although respondents largely retreat from the substance of the court of appeals' APA ruling, they zealously embrace that court's conclusion (Pet. App. 14a) that the Secretary's curative retroactive rule "make[s] a mockery of" administrative procedure. See Resp. Br. 22-38. Respondents' arguments in this connection, however, mischaracterize the district court's decision, confuse (once again) the concepts of legal effectiveness and retroactivity, misapprehend the purpose of the APA's notice and comment requirement, and ignore the very real limitations that the APA's arbitrary and capricious standard imposes on the promulgation of retroactive rules.

a. First, respondents repeatedly mischaracterize the district court's 1983 decision invalidating the Secretary's 1981 rule. As explained in our opening brief (at 15-18), that decision did not order the Secretary to pay respondents in accordance with the Secretary's prior 1979 rule; nor did it deny the Secretary any right subsequently to promulgate a retroactive rule on remand. As its terms make clear (see Pet. App. 64a), the 1983 order simply invalidated the 1981 rule. It did not finally decide the question of the appropriate standard to be applied in calculating the wage cost reimbursement owed to respondents under the Medicare program. Indeed, the district court specifically refused to issue an order barring the Secretary from applying the 1981 rule to respondents' reimbursement claims, holding that the provisions of the Medicare statute requiring exhaustion of administrative remedies deprived the court of any authority to issue such an order. Hence, the Secretary's decision not to appeal that order did not reinstate the Secretary's prior 1979 rule so as to preclude any subsequent retroactive rulemaking.

Nor do the numerous decisions cited by respondents (Br. 23) support the assertion "that the usual effect of invalidating a rule that purports to repeal an earlier rule is to leave in place the earlier rule" so as to preclude the agency's subsequent promulgation of a retroactive curative rule. In the lone decision of this Court cited by respondents, *United States* v. *Baltimore & O. R.R.*, 284 U.S. 195 (1931), the Court invalidated the administrative agency's order, but did not reinstate a prior agency order. It merely acknowledged the continuing validity of a *private* agreement that was entered into prior to the invalid order (*id.* at 203-204). That result was, moreover, compelled by a statutory provision barring the agency from promulgating any order with retroactive effect (see *id.* at 199).

In addition, although many of the lower court decisions cited by respondents (Br. 23) do hold that the legal effect of a court's invalidation of an agency rule may be to reinstate the agency's prior rule,[3] they do not support respondents' further claim that the necessary effect of reinstatement is to bar the agency from subsequently promulgating a retroactive curative rule. Indeed, the lower courts typically assume that retroactive correction may be possible. See, *e.g.*, *Cumberland Medical Center* v. *Secretary of Health & Human Services*, 781 F.2d 536, 538-539 (6th Cir. 1986); *Menorah Medical Center* v. *Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); see also *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435, 1453 n.35 (11th Cir. 1987), cert. denied, No. 87-380 (Apr. 25, 1988); *Mason Gen. Hosp.* v. *Secretary of Dep't of Health and Human Services*, 809 F.2d 1220, 1223, 1229 (6th Cir. 1987).[4]

[3] The cases upon which respondents (and the court of appeals in this case (Pet. App. 13a)) rely almost invariably cite the D.C. Circuit's statement in *Action on Smoking & Health* v. *CAB*, 713 F.2d 795, 797 (1983) that the effect of invalidating an agency rule is to "reinstat[e] the rules previously in force." That statement did not, however, purport to establish an invariant rule of administrative law. The reinstatement of the prior rule was ordered in that case only because the agency had engaged in "repeated technical noncompliance" with the APA (*id.* at 802). In any event, as we explained in our opening brief (at 16-17), respondents' contrary view advances an unworkable principle of administrative law that would improperly permit courts to usurp agency responsibility for the implementation of federal statutes and could have the effect of reinstating a prior rule that has already been found unsatisfactory. For this reason, it would prompt agencies to seek review of many more lower court decisions invalidating agency rules based on procedural defects.

b. Respondents argue (Br. 27-35) that a retroactive curative rule is impermissible where, as in this case, the initial legal error committed—violation of the APA's notice and comment requirement—"is one that by its very nature cannot be corrected retroactively" (Br. 27). Indeed, respondents assert (Br. 28) that if an agency's first effort is judicially invalidated on procedural grounds, the agency "can make the change in policy effective thirty days after it has completed the required prerequisites, but it cannot make the change retroactive to the date that it originally intended." Respondents accordingly argue (*ibid.*) that because the Secretary had to comply with the APA's procedural requirements, including notice and comment, "by June 1, 1981 (thirty days in advance) for the rule to be effective on July 1, 1981, it is axiomatic that the agency could not cure the 'legal error' by undertaking the steps in 1984."

Respondents forget, however, that a rule may be effective in the future, yet, once effective, may concern transactions that were completed prior to its effective date. In this case, for example, the effective date of the Secretary's 1984 retroactive rule was 30 days *after* its promulgation. See 49 Fed. Reg. 46495 (1984); J.A. 29. The rule did not purport to have an effective date of July 1, 1981.[5] Hence, contrary to respondents' claim,

[4] Respondents' effort to distinguish *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947) is unpersuasive. Although *Chenery*, unlike this case, involved an adjudicative order, the principle of administrative law it established—that "[t]he fact that the Commission had committed a legal error in its first disposition of the case certainly gave [the respondents] no vested right" (*id.* at 200-201)—applies with even greater force to the rulemaking setting. Nor can a valid distinction be drawn based on differences between the legal error committed by the agency in the two cases. In both cases, the agency committed a legal error that did not mean that the substance of the rule was also invalid.

[5] For this reason (and others), the reasoning of respondents' hypothetical based on Agencies A, B, and C, is likewise flawed. Contrary to respondents' claim (Br. 30), the Secretary here did not, like Agency C in respondents' hypothetical, republish its rule in 1984 "after following notice and comment procedures, and once again [make] the rule effective July 1, 1981."

the 1984 rule did satisfy the APA's procedural requirements, including notice and comment, at least 30 days prior to its effective date.[6]

Respondents also wrongly assume that the purpose of the notice and comment requirement is to afford those whose activities are covered by the proposed regulation an opportunity to modify their conduct prior to the final regulation's effective date. The notice and comment procedure serves an important, yet distinct, function. It informs the public, including potentially affected parties, of the substance of the proposed rule and thus provides those interested with an opportunity to comment on the rule's substance prior to its formally becoming law.[7] To be sure, the notice requirement also makes it possible for affected parties to adjust their conduct before the effective date—and thus to limit the potential impact of the regulation—but it does not mean that the regulation, once effective, may apply only to conduct occurring in the future.[8]

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[6] For this reason, respondents' statute of limitations analogy also fails (Resp. Br. 28).

[7] The public receives notice on at least two occasions: when the proposed regulation is published in the Federal Register and when the final regulation is published, which must be at least 30 days before the regulation's effective date, except in specified circumstances (see 5 U.S.C. 553(d); Pet. Br. 25 n.15).

[8] Respondents nonetheless argue (Br. 36 & n.40) that they have been harmed because notice and comment occurred after their costs were incurred and, consequently, they were not able to adjust their behavior during the delay that typically occurs between the time a rule is first proposed and the time that it is formally made final and effective. By respondents' own account (Br. 35), however, it is quite unlikely that they would have made any such adjustment, because they "operate under established labor and supply contracts that generally cannot be terminated at will." Indeed, for this reason, respondents argue that they should be entitled to a "one or two year grace period[]" (*ibid.* (emphasis deleted)). The APA, however, confers no such statutory right on respondents. In any event, respondents' claim of prejudice is relevant only to the question whether the Secretary's decision to impose this particular curative rule retroactively was arbitrary and capricious, a question we address in our opening brief (at 36-40). It does not provide a ground for invalidating all retroactive curative rules.

c. Respondents next attack the Secretary's curative retroactive rule by arguing (Br. 30-31) that if curative rulemaking is allowed there is no reason why "any agency that wants to make a rule effective immediately [would] bother to comply with APA public participation procedures in the future." Contrary to respondents' claim, however, an agency that wants to achieve a substantive change in an administrative rule has (as it should be) every incentive to comply fully with the APA, regardless of the availability of curative rulemaking.

By complying with APA procedural requirements in the first instance, an agency can promulgate a rule with an early effective date and thus avoid any need for a curative retroactive rule. By contrast, if an agency complies with the APA only after having its initial rule invalidated on procedural grounds, it will necessarily promulgate a rule with a much later effective date. Hence, its initial noncompliance means that the rule will have to be retroactive just to cover the time period that would have been covered without retroactive effect had the agency simply complied in the first place.

Moreover, respondents ignore that a curative retroactive rule is subject to judicial review. In determining whether an agency's decision to impose a curative rule retroactively is arbitrary and capricious, a court will clearly not be disposed in the agency's favor if it perceives (as posited by respondents) that the agency has deliberately violated the APA's procedural requirements in a calculated effort to lay the foundation for a subsequent claim that any retroactivity was merely curative in nature.[9] Because, moreover, public comment on the proposed change might require a substantive modification of the proposed rule, the agency cannot assume that it will be able to rely heavily on the merely curative character of its final rule to justify the rule's retroactive impact.

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[9] There is no evidence in this case to suggest that the Secretary acted other than in good faith in promulgating both the 1981 cost limit rule and the 1984 retroactive rule. Indeed, the Secretary can hardly be accused of bad faith given his decision to comply with APA notice and comment requirements in promulgating provider reimbursement regulations under the Medicare Act, notwithstanding the exemption from those requirements under the APA for public property, loans, grants, benefits, or contracts (see Pet. Br. 6 n.3).

d. Respondents and amicus AHA also argue (Resp. Br. 32; AHA Amicus Br. 21) that curative rulemaking should be barred because, they suggest, it is difficult to persuade an agency on judicial remand to change the substance of a rule that has been invalidated on procedural grounds. These speculations, however, are not grounded in concerns that are unique to, or even disproportionately associated with, curative retroactive rules. Precisely the same concerns exist if, following judicial remand, the agency promulgates a rule that is only prospective in effect. In either circumstance, the agency has previously announced what it believes the rule of law should be. Whether the rule is both retroactive and prospective or merely prospective is wholly incidental to the substance of the rule.

Here again, respondents ignore the important safeguards provided by judicial review. As we explained in our opening brief (at 20-21), an agency is required on remand to consider any information obtained during further notice-and-comment proceedings and to respond to significant comments made. The agency may be persuaded by those comments to change the substance of the rule, or a court may set aside the agency's action if it acts arbitrarily and capriciously in failing to modify the rule in response to comments (see 5 U.S.C. 706(2)(A)). But in any event, the possibility that some agencies might fail to comply in good faith with APA procedural requirements following judicial remand does not support respondents' extravagant claim (Br. 22) that all curative rulemaking is "an affront to the integrity of the administrative process."[10]

e. Finally, perhaps the greatest flaw in respondents' analysis is their failure to acknowledge that an agency must independently justify its decision to allow a rule to have retroactive effect. Respondents repeatedly claim (Br. 30-31; see also *id.* at 27-30) that under our view an agency can violate the APA's procedural requirement yet "easily achieve its original purpose by simply pursuing retroactive rulemaking." As we ex-

[10] Respondents' baseless accusation (Br. 34 n.38), repeated by amicus AHA (Br. 18-21), that the Secretary has engaged in "outright abuse of the judicial system" concerns matters far afield from this case and, in any event, merits no response.

plained in our opening brief (at 36-40), however, we are not suggesting that an agency's decision to promulgate a retroactive rule, including a rule that is curative in nature, is automatically valid. The decision to apply a rule retroactively is subject to judicial review under the arbitrary and capricious standard. To apply that standard, a court must determine whether "the mischief of producing a result which is contrary to a statutory design or to legal or equitable principles * * * is greater than the ill effect of the retroactive application of a new standard." *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947); see Pet. Br. 37.[11] For the reasons described in our opening brief (at 36-40), and below (pages 15-17, *infra*), the Secretary's decision to apply its 1984 cost limit rule retroactively was not arbitrary and capricious.

3. The gravamen of respondents' more focussed attack on the Secretary's 1984 retroactive cost limit rule is the contention that retroactive cost limit rules are specifically barred by Section 223(b) of the Social Security Amendments of 1972, Pub. L. No. 92-603, 86 Stat. 1393. Section 223(b) amended Section 1861(v)(1)(A) to allow the Secretary to promulgate cost limit rules on a presumptive and class-wide basis (see Pet. Br. 34 & n.26). According to respondents (Br. 10-13, 14-15, 18-19), this amendment deprives the Secretary of any authority to apply the 1984 rule retroactively either pursuant to his general rulemaking authority under the Medicare Act (see 42 U.S.C. (& Supp. III) 1395x(v)(1)(A), 1395hh, 1395ii) or pursuant to his authority

[11] Hence, respondents are wrong in asserting (Br. 31 n.34) that the "logical consequences of the Secretary's position" is that, following this Court's invalidation in *Morton* v. *Ruiz*, 415 U.S. 199 (1974), of a rule promulgated by the Bureau of Indian Affairs (BIA), the BIA was "free to reinstate the [prior rule] retroactively by a 'curative' publication * * * and then proceed to recoup from [the individual] the amounts he received as a result of this Court's decision." The Court invalidated the BIA's rule on both procedural and substantive grounds and, consequently, the BIA obviously could not simply repromulgate the same rule as before after complying with the procedural requirements previously violated. In addition, even if the BIA's initial error had been only procedural in character and the BIA had subsequently sought to promulgate a retroactive rule, it is far from certain that the agency's decision would not have been deemed arbitrary and capricious. Significantly, the individual affected by the BIA's rule in *Morton* v. *Ruiz*, unlike respondents in this case (see Pet. Br. 38-39), had not received any formal notice of the substance of the agency's rule prior to its application to him (see 415 U.S. at 234-236).

under Clause (ii) to issue regulations that "provide for the making of suitable retroactive corrective adjustments". Although respondents argue that their proffered construction is supported by the statutory language[12] and the Secretary's prior administrative construction of Section 223(b),[13] the only significant evidence they muster in support of their view is a single sentence, reproduced in two legislative reports. See H.R. Rep. 92-231, 92d Cong., 1st Sess. 83 (1971) ("[The] authority to set limits on costs recognized for certain classes of providers * * * would be exercised on a prospective, rather than a retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable."); S. Rep. 92-1230, 92d Cong., 2d Sess. 188 (1972) (same). As we explained in our opening brief (at 35), however, those statements focus only on the Secretary's authority to promulgate cost limit rules in the first instance. They do not purport to speak to the distinct question raised in this case, which is whether the Secretary has authority, following judicial invalidation of a wholly prospective rule on procedural grounds, to promulgate a new rule on remand that applies to the same period

[12] Respondents argue (Br. 10 (emphasis in original)) that Section 223(b)'s language expressly "requires the Secretary to establish the limits *before* the beginning of the period to which they apply," because it states that the Secretary's regulations "may provide for the establishment of limits on the direct or indirect overall incurred costs * * * *to be recognized* as reasonable * * *" (42 U.S.C. (& Supp. III) 1395x(v)(1)(A) (emphasis added)). We have already explained in our opening brief (at 34 n.25), however, that the phrase "to be recognized" simply reflects that, by their very nature, *re*imbursement determinations (when costs are "recognized") occur after costs have been incurred.

[13] As we explained in our opening brief (at 35 & n.27), respondents' reliance on previous occasions where the Secretary has commented on the prospective effect of particular cost limit rules is misplaced. On none of those occasions did the Secretary intimate that a curative cost limit rule could not be retroactive. For example, in the decision of the Deputy Administrator of the Health Care Financing Administration in *Beth Israel Hosp.* v. *Blue Cross Ass'n*, Medicare and Medicaid Guide (CCH) ¶ 31,645 (reproduced at J.A. 64-75), upon which respondents rely (Br. 12), the Secretary's delegate refers only to the Secretary's "*general policy* to apply cost limits prospectively" (J.A. 69 (emphasis added)).

that would have been covered by the invalidated rule. As further explained in our opening brief (at 35-36), moreover, very different considerations apply in the present circumstances, particularly because the substance of the 1984 rule is identical to the prospective rule promulgated in 1981.[14]

4. Respondents' grounds for resisting the Secretary's construction of Clause (ii) are equally unpersuasive. The Secretary's construction of Clause (ii) is neither inconsistent with the statutory languge (see Resp. Br. 15-16) nor contrary to the Secretary's view of the provision soon after its enactment (*id.* at 17-18).[15]

First, as we explained at length in our opening brief (at 43-44), the language of Clause (ii) can be rationally construed as authorizing the Secretary to issue a retroactive regulation of general application where, as in this case, the application of a prior cost reimbursement regulation has resulted in systemically excessive or inadequate reimbursement. The terms "adjustments," "a provider of services," and "aggregate reimbursement" are not to the contrary. An erroneous cost limit rule can, as in this case, produce "aggregate reimbursement" that is "inadequate or excessive" for "a provider of services" and others similarly situated and an "adjustment" can be made to "correct"

[14] Respondents argue (Br. 13 n.11) that the Secretary cannot rely on the 1981 rule as supplying them with advance notice because that rule was held invalid. As we explained in our opening brief (at 38-39), however, respondents incurred of all their rel. ant costs prior to judicial invalidation of the 1981 rule, and although they were of course then free to hope that the rule would subsequently be invalidated on procedural grounds (as they likely still hope that the new rule will be invalidated on substantive grounds should their current challenge fail), they cannot claim, in effect, an entitlement to that result based on their own unilaterally-created expectations. Respondents offer no precedential support for their novel theory that they were entitled to ignore the 1981 rule because they thought it was "patently invalid" at the time (Br. 13 n.11, 36 n.41)).

[15] We have already explained in our opening brief (at 40-41 n.34) why respondents' threshold contention (Br. 13-14) that the Secretary cannot now rely on Clause (ii) because he never relied on it during the rulemaking proceedings is incorrect.

the error by a retroactive rule. The other words emphasized by respondents (Br. 15), including "particular provider[]" and "particular period," appear nowhere in Clause (ii).

Indeed, the statutory language supports the Secretary's reading of the provision. The literal terms of Clause (ii) provide that cost limit regulations shall themselves provide for "suitable retroactive corrective adjustments."[16] They also direct the Secretary to focus on the "method" that prompted the reimbursement error requiring corrective action. As we explained in our opening brief (at 46-47), where, as in this case, the "method" that prompted the intitial error was a cost limit rule, the error is often best redressed by changes in the rules themselves, and only retroactive application of those changes will achieve the required "adjustment" in the prior erroneous reimbursement award.

Although the legislative history is silent on the question,[17] the Secretary's reading is also supported by the historical development of the Medicare law. As we explained in our opening brief (at 44-45, 46-47), Clause (ii)'s meaning has not been static since its original adoption in 1965. It is one subsection within a larger provision governing Medicare reimbursement and, by its very wording, derives its full meaning from the contents of the entire provision. Hence, as that provision has undergone amendment—for instance with the passage of Section 223(b) in 1972—the scope and meaning of Clause (ii) has correspondingly

[16] Clause (ii) begins with the phrase "[s]uch regulations," which logically includes cost limit rules (see Pet. Br. 44).

[17] Respondents wrongly assert (Br. 18 n.18) that "[t]he Secretary's discussion of the legislative history is contradictory." Our statement that the legislative history of Section 223(b) does not discuss Clause (ii) or its relationship to the Secretary's authority to promulgate cost limit rules does not "contradict[]" our earlier acknowledgement that, prior to Section 223(b), "excessive costs could be disallowed only on a case-by-case basis" (Pet. Br. 35). The latter statement did not address the meaning of Clause (ii) following congressional passage of Section 223(b)—which is the issue raised in this case. Indeed, the quoted statement does not speak at all to the meaning of Clause (ii) at any time or even refer to any legislative history concerning that statutory provision. It merely describes in general terms the Medicare reimbursement scheme prior to the addition of Section 223(b) in 1972.

evolved. A scheme for "retroactive corrective adjustments" through cost limit rules of general application is a sensible, if not necessary, complement to Congress's authorization of class-wide cost limit rules.

For this reason, moreover, respondents' reliance on any statements purporting to construe the scope of Clause (ii) prior to 1972 is misplaced (see Resp. Br. 17), as is respondents' related contention that the Secretary's current construction is not entitled to deference on that account (*id.* at 18-19). In any event, the testimony of a government official quoted by respondents (*id.* at 17 & n.16) does not show that the Secretary's current construction of [Clause (ii)] "conflicts with the construction adopted by the agency near the time of the provision's enactment." A curative retroactive cost limit rule that achieves "suitable retroactive corrective adjustments" does not " 'retroactively change the principles' " (*ibid.* (quoting *Reimbursement Guidelines for Medicare: Hearings Before the Senate Comm. on Finance,* 89th Cong., 2d Sess. 56 (1966) (emphasis deleted) (testimony of Robert M. Ball, Commissioner of Social Security Administration)). Such a rule simply ensures that the "principles" are maintained by redressing errors in their implementation. In this case, for instance, respondents incurred all of their relevant costs after the Secretary's 1981 regulation was promulgated and before it was invalidated on procedural grounds.[18]

5. Finally, respondents' assertion (Br. 38-50) that the Secretary's decision to promulgate a retroactive rule was itself arbitrary and capricious is unpersuasive for two reasons. First, respondents' description (*id.* at 38-40) of the "ill effects" of retroactivity rests on mischaracterizations of the impact of the 1984 rule. Second, their argument that the rule does not serve "any statutory interest" (*id.* at 40-50) is mistakenly directed to

[18] The testimony upon which respondents rely does not, moreover, even clearly concern Clause (ii). The then-Commissioner of the Social Security Administration never specifically refers to Clause (ii) in the excerpts quoted and we believe that he was more likely referring to an entirely different provision, 42 U.S.C. (Supp. I 1965) 1395g, which authorized a year-end settling of accounts, rather than to Clause (ii).

the substantive validity of the rule, which is not now at issue before the Court.

a. Respondents assert (Br. 39; see *id.* at 24, 34-35) that the Secretary's 1984 retroactive cost limit rule is unjust because it seeks "to recoup monies previously paid by the agency as a result of final court judgment." Contrary to respondents' intimation, however, no monies were paid to them pursuant to a court order, which, as discussed above (see page 5, *supra*), did not order reimbursement under the prior 1979 rule. Respondents were instead paid pursuant to the Medicare cost reimbursement procedures, which were not the subject of the district court's order. Those payments, moreover, were expressly made subject to reopening and recoupment in the event of an adjustment in the amount of reimbursement as the result of the adoption of a new wage cost regulation. See, *e.g.*, Letter from R.M. Hugney to Robert B. Johnson (Jan. 31, 1984) (App., *infra*, 5a); 42 C.F.R. 405.1885.

Nor are respondents correct in characterizing the rule as having "the effect of rewarding the Secretary for his illegal conduct" (Br. 40). In 1983, the district court invalidated the Secretary's 1981 rule on procedural grounds and, rather than appeal that ruling, the Secretary chose to correct the error by promulgating a new rule in accordance with the district court's decision. The Secretary is thus in no manner "reward[ed]" by his 1984 rule.

By contrast, an economic windfall is precisely what respondents obtained in the court of appeals and what they now, in effect, ask this Court to preserve. As we explained in our opening brief (at 15-18, 36-40), respondents seek to convert a purely procedural victory into a substantive victory on the merits that entitles them, in contravention of Congress's mandate, to reimbursement for costs inefficiently incurred.[19] The

[19] Respondents wrongly claim (Br. 29) that we believe "procedural" errors are "insignificant." Our point is simply that the options before an agency are different where, as in this case, the court invalidates a rule based on procedural error, as opposed to where an invalidation is based on a substantive defect in the rule. In the case of a procedural error, the agency may correct the error by complying with applicable procedures that may, or may not, prompt a substantive change in the regulation at issue. Where, however, the error is substantive in nature, the agency can, of course, correct its error only by modifying the substance of its prior rule.

district court's 1983 ruling entitled them, however, only to certain notice and comment procedures—which they have since received—and not to any particular substantive result.

b. Respondents and their supporting amici also attack (Br. 40-50; Sisters of Mercy Health Corp. Amicus Br. 17-25) the Secretary's rule on the ground that it serves no "statutory interest." As respondents concede (Br. 38 n.43), however, the gravamen of their argument is that the substance of the rule is arbitrary and capricious, regardless of any retroactive effect. Neither the district court nor the court of appeals addressed that question, however, and for the reasons outlined in our opening brief (at 37 n.29, 38 n.30), this Court should not consider it in the first instance either.[20]

[20] Contrary to respondents' assertion (Br. 38 n.43) the Secretary is not "ask[ing] this Court to determine that the [1984] rule is not arbitrary and capricious." We expressly stated (Pet. Br. 37 n.28) that the substantive validity of the rule should not be decided. The only issue we discussed was whether the decision to impose the rule *retroactively* was arbitrary and capricious (see *id.* at 36). We do not maintain that the Court must address that issue now, but only that if the Court addresses the issue, it should do so based on the assumption that the rule is substantively valid because neither of the lower courts held to the contrary (see Pet. Br. 38 n.30). In any event, it is clear that the 1984 wage index rule created a more accurate wage index by excluding federal hospital wage data and, hence, it serves the Medicare Act's requirement that the Secretary pay only those costs "necessary in the efficient delivery of needed health services" (42 U.S.C. (Supp. III) 1395x(v)(1)(A)).

For the foregoing reasons, and the reasons stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DONALD B. AYER*
Acting Solicitor General

JULY 1988

* The Solicitor General is disqualified in this case.

APPENDIX

MEDICARE
Group Hospitalization, Inc.
serves as intermediary for
Medicare Part A in the
Washington, D.C.
metropolitan area

Group Hospitalization, Inc.
550 12th Street, S.W.
Washington, D.C. 20024
202/479-8000

January 31, 1984

Mr. Robert B. Johnson
Executive Director
D.C. General Hospital
19th & Massachusetts Avenue, S.E.
Washington, D.C. 20003

RE: Notice of Program Reimbursement
Provider No. 09-0007
FYE: September 30, 1982

Dear Mr. Johnson:

We have completed our examination of the Medicare Statement of Reimbursable Cost which you submitted for the period referenced above. In accordance with Medicare Regulation Section 405.1803, Exhibit A (attached) shows our determination of program reimbursement due your facility in comparison to the amount shown on the report which you filed. The adjustments which produce any difference between our determination and your report are shown in the attached audit adjustment report which references applicable Medicare regulations. The Statement of Final Cost Settlement (Exhibit B) includes the tentative settlement and reflects the net amount due the provider/(program).

If additional explanation is needed of the difference between total reimbursement claimed and the amount determined based on our examination, please contact this office. Revision of this notice may be required by the findings of an audit of this or a subsequent cost report.

If the attached Exhibit B indicates a net amount due your facility, our check is enclosed. If there is a net amount due the program, we are hereby requesting payment in full for the amount indicated in brackets. To insure timely receipt of your payment, please forward your check payable to Group Hospitalization, Inc. to the attention of George D. Pitzer, Staff Assistant, Provider Reimbursement Department.

If a lump-sum payment is not possible, you must submit within 15 days from the date of this letter the proposed method of repayment. If the proposed repayment plan is not received and/or approved or a check for the amount indicated in the Statement of Final Cost Settlement (Exhibit B) is not received in 30 days from the date of this letter, a minimum 20% claims payments withholding will be implemented on the 31st day to begin recoupment.

If total recoupment cannot be completed by direct payment from the provider, withholding of claims payments or an extended repayment plan has not been approved, a complete suspension of payments will be imposed 60 days from the date of this letter. Once a withholding or suspension of claims payments is initiated, it must continue to stay in effect until (1) the amount due is paid in full by the provider, (2) the overpayment is eliminated by the claims payment withholding or (3) a repayment plan has been approved by the intermediary or the HCFA Regional Office. In accordance with Section 1866(b)(2)-(A) and (C) of Title XVIII, failure to respond may result in termination of your Medicare participating agreement.

In accordance with Public Law 97-248, interest will be assessed on the amount due the program if payment in full is not received within 30 days of the date of this letter. Interest will be

charged on the unpaid balance and will be calculated for each 30 day period using the following formula:

Principal × Interest Rate = Interest for year
divided by 12 = 30-day interest

For periods of less than 30 days the full monthly interest charge will be applied. (Thus, if payment is received 31 days from the date of this letter, two 30 day periods of interest will be charged). Each payment will be applied first to the accrued interest and then to the principal. After each payment, interest will accrue on the remaining balance at the quarterly rate in effect at the time of this letter. The rate of interest to be charged is based on the current value of funds to the Treasury as issued by the Department of Treasury for the quarter in which this determination was made. This rate will also apply to approved repayment schedules which also must be accompanied by a signed Prommisory Note. The interest rate for determinations from January 1, 1984 through March 31, 1984 is 9.0 percent.

If you are dissatisfied with our determination, and the amount of program reimbursement in controversy is at least $1,000, but less than $10,000, you have a right to a hearing as provided for by Regulation Section 405.1811. You must file a request for a hearing within 180 days from the date of this letter. To be acceptable, such a request must: (1) be in writing, (2) specify the individual adjustment items and amounts to which you take exception, (3) state the reasons supporting your position, and (4) cite the regulation and manual sections upon which you base your exceptions. You may include any additional material you wish to have considered in support of your position.

Request for a hearing must be sent to:

Medicare Provider Appeal's Coordinator
Blue Cross and Blue Shield Association
676 North St. Clair Street
Chicago, Illinois 60611

A copy of your request must be sent to:

Manager
Provider Reimbursement Department
Group Hospitalization, Inc.
550 12th Street, S.W.
Washington, D.C. 20024

If the amount in controversy is $10,000 or more in program reimbursement, you have a right to appeal your dispute to the Provider Reimbursement Review Board established under Public Law 92-603. Instructions for appeal are contained in Regulation No. 5 of the Social Security Administration (20 CFR Part 405) Subpart D, Section 405.1801 – 405.1889. Your request must be directed to:

Paul M. Ganeles
Chairman
Provider Reimbursement Review Board
Room 104
Professional Building
6660 Security Boulevard
Baltimore, Maryland 21207

Copies of your request must be sent to the attention of the Provider Reimbursement Department, Group Hospitalization, Inc. and to Blue Cross and Blue Shield Association as follows:

PRRB Appeals Coordinator
Blue Cross and Blue Shield Association
676 North St. Clair Street
Chicago, Illinois 60611

For information on proper form and required content of an appeal request and for assistance in determining the forum to which your request should be directed, please contact me at (202) 479-8415. In addition, we strongly urge that you discuss with us any problems you may have with the adjustments we have made. Since you have 180 days from the date of this Notice of Program Reimbursement to formally file an appeal request,

there is ample opportunity for discussion without risk of any prejudice to your appeal rights.

The portion of this notice of program reimbursement and accompanying adjustment report which includes federal hospital wage data in the computation of Medicare schedule of limits on hospital per diem inpatient general routine operating cost is subject to modification and revision pursuant to any subsequent notice published in the Federal Register excluding such federal hospital wage data. Consequently, Medicare payments based on the inclusion of federal hospital wage data are subject to recoupment.

Sincerely,

/s/ R. M. HUGNEY
R. M. Hugney
Staff Assistant
Provider Reimbursement

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